LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7728 | **NOTE PREPARED:** Jan 21, 2005
BILL NUMBER: HB 1718 | **BILL AMENDED:**

SUBJECT: Residential Redevelopment.

FIRST AUTHOR: Rep. Mahern | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill authorizes the designation of residential redevelopment areas in Indianapolis and second class cities. The bill provides for the acquisition of real property subject to a tax sale for purposes of residential redevelopment. It provides an assessed valuation deduction for the rehabilitation or redevelopment of residential property in a residential redevelopment area. It provides an Income Tax credit for Sales Taxes paid on building materials used to construct or rehabilitate residential property in a residential redevelopment area. It also provides an Income Tax credit for the purchase of a newly constructed or rehabilitated property used as a primary residence in a residential redevelopment area.

Effective Date: July 1, 2005.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the two tax credits established by the bill. The DOR's current level of resources should be sufficient to implement these credits.

Property Tax Deduction: The state levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. The annual revenue reduction under this proposal is indeterminable. (See discussion of this provision under *Explanation of Local Revenues*.)

Explanation of State Revenues: *Building Materials Tax Credit:* The bill establishes a nonrefundable tax credit against the Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, and Financial Institutions Tax for the sales tax paid on purchases of building materials used in new construction or rehabilitation of a residence located in a residential redevelopment area. The tax credit is effective beginning in tax year 2006. Thus, the fiscal impact of the credit could, at the earliest, be initiated in FY 2007. The amount of credits that could potentially be claimed by taxpayers is indeterminable and contingent on several factors, including cost of building materials, consumer demand for housing in residential redevelopment areas that might be designated, and other housing market influences. Since the tax credit is nonrefundable and carryover is limited to five years, the extent of the revenue loss from the tax credit also depends on the tax liabilities of individuals and entities claiming the credits. Estimates of the potential tax credit per new home constructed in a residential redevelopment area are presented in the table below. These estimates are based on the home construction cost range developed below (see below under *Analysis of Home Construction in Pertinent Indiana Cities*) and assume that 40% of this cost is attributable to materials purchases. Credits could potentially be less to the extent that rehabilitation projects possibly costing less than new construction are undertaken in residential redevelopment areas.

Construction Cost*	**Materials Cost**	**Tax Credit for Materials Sales Tax Credit per New Home**
$ 78,050	$ 31,220	$ 1,873
$ 111,403	$ 44,561	$ 2,674
$ 132,323	$ 52,929	$ 3,176
$ 136,801	$ 54,720	$ 3,283

*Highest construction cost is based on average for Indianapolis.

A taxpayer may carry forward any unused credit amount from a taxable year for up to five subsequent taxable years. However, a taxpayer may not carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity.

Home Purchase Tax Credit: The bill establishes a nonrefundable individual AGI Tax credit for purchase of a newly constructed or rehabilitated home in a residential redevelopment area. To qualify for the tax credit, the taxpayer must use the home as his or her primary residence. The credit is equal to the lesser of (1) 10% of the purchase price or (2) $5,000. The tax credit is effective beginning in tax year 2006. Thus, the fiscal impact of the credit could, at the earliest, be initiated in FY 2007. The amount of credits that could potentially be claimed by taxpayers is indeterminable and contingent on several factors, including construction/rehabilitation costs, consumer demand for housing in residential redevelopment areas that might be designated, and other housing market influences. Since the tax credit is nonrefundable and carryover is limited to five years, the extent of the revenue loss from the tax credit also depends on the tax liabilities of individuals claiming the credits. It is estimated that the tax credit per taxpayer could potentially equal the maximum of $5,000 in most cases. This is based on the home construction cost range developed below assuming a 5% margin by the seller (see below under *Analysis of Home Construction in Pertinent Indiana Cities*). This also assumes that the new home "price is a relatively good indicator of pricing for rehabilitated homes in a residential redevelopment area. A taxpayer may carry forward any unused credit amount from a taxable year for up to five subsequent taxable years. However, a taxpayer may not carry back any unused credit.

Timing of Fiscal Impact: Both tax credits are effective beginning in tax year 2006. However, the timing of the fiscal impact depends on establishment of residential redevelopment areas and construction/rehabilitation activity in these areas. Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is distributed to the state General Fund. Eighty six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Potential Secondary Tax Impacts: Construction of new homes and rehabilitation of existing homes in residential redevelopment areas would result in: (1) taxable wage payments to construction and other workers employed on residential construction and rehabilitation projects; and (2) purchases of heating/air conditioning systems, water heaters, water softeners, various appliances, furniture, and other housewares. The income and sales tax revenue from these taxable activities serves to offset the impact of the tax credits established by the bill, but only to the extent that they would not have occurred in the absence of the residential redevelopment areas.

Analysis of Home Construction in Pertinent Indiana Cities: The bill limits the number of residential redevelopment areas to: (1) two in Indianapolis; (2) two in a second class city in which at least 20% of the households in the city are below the poverty level as established by the most recent U.S. Census; and (3) one in all other second class cities. Currently, there are 19 second class cities that would be affected by this bill. Two cities (Carmel and Columbus) that have met the second class city population requirement, but have not adopted second class status, are not expected to meet other distress criteria for residential redevelopment areas. In addition, only four of the cities (Bloomington, East Chicago, Gary, and Muncie) meet the poverty requirement described in (2) above. So a statewide maximum of **25** residential redevelopment areas could potentially be established under this bill. In addition, the distress criteria and income requirements for renters and home purchasers in the residential redevelopment areas could potentially limit the size of a typical redevelopment area to four to eight square blocks. (See explanation of distress criteria under *Explanation of Local Expenditures*.) Assuming that cities establish residential redevelopment areas, the rate at which construction and rehabilitation will proceed in each area is indeterminable. However, in most residential redevelopment areas, redevelopment projects qualifying for tax incentives could potentially occur over several years and not accrue over a brief period of time.

An analysis of annual building permit totals for new construction of single-family homes in Indianapolis and second class cities is presented in the table below. The table reports the average annual permit total for each city for the period 1998-2003; and the average construction cost per home for the same period. Information was unavailable for Bloomington, Marion, and South Bend, and the group statistics exclude Indianapolis because of its scale.

City*	Average Annual Bldg. Permits for Single-Family Homes 1998-2003	Average Construction Cost for Single Family Homes 1998-2003
Anderson	115	$119,389
East Chicago	8	$96,033
Elkhart	53	$120,458
Evansville	130	$78,050
Fort Wayne	235	$115,733
Gary	18	$121,573
Hammond	15	$126,364
Kokomo	172	$119,663
Lafayette	235	$97,966
Lawrence	408	$132,323
Michigan City	71	$82,655
Mishawaka	116	$125,327
Muncie	49	$81,723
New Albany	90	$104,246
Richmond	37	$107,072
Terre Haute	109	$86,430
Minimum	**8**	**$78,050**
Median	**100**	**$111,403**
Maximum	**408**	**$132,323**
Indianapolis	3,831	$136,801

*Information unavailable for Bloomington, Marion, and South Bend.
Source: U. S. Census Bureau, *Building Permits Database*.

Explanation of Local Expenditures: The bill permits the Indianapolis Metropolitan Development Commission (MDC) and the redevelopment commissions in second class cities to establish residential redevelopment areas in which tax incentives would be provided for construction of new homes and rehabilitation of existing homes. (See discussion above under *Explanation of State Revenues* regarding potential incidence of residential redevelopment areas around the state.) The criteria for a residential redevelopment area are as follows:

(1) The area must previously have been developed as a residential or commercial area.
(2) At least 20% of the area's real estate parcels are vacant or contain buildings requiring rehabilitation.
(3) At least 50% of the families and individuals living in the residential redevelopment area earn less than the

area's median income.
(4) That there is a documented need for affordable housing in the city.

The bill also requires that at least 40% of the housing in a residential redevelopment area will be leased or sold to individuals earning no more than 80% of the area's median income. Reportedly, these criteria could potentially limit the size of residential redevelopment areas to eight to ten square city block areas. The bill requires the MDC or a redevelopment commission to adopt a plan for a residential redevelopment area and to obtain approval of the plan from the city's legislative body. In addition, the MDC or redevelopment commission must obtain approval of the plan from the Indiana Housing Finance Authority (IHFA) if tax incentives are going to be provided. Once the approvals have been obtained, the MDC or redevelopment commission must adopt a resolution including the redevelopment area plan and hold a public hearing on the plan. After the public hearing, the MDC or redevelopment commission must either rescind, amend, or confirm the resolution.

The bill allows an MDC or redevelopment commission to transfer property located in a residential redevelopment area that has failed to be sold at the tax delinquent property sale to an entity that agrees to develop the property. The entity must agree to develop the property in accordance with the residential redevelopment area plan adopted by the MDC or redevelopment commission.

Explanation of Local Revenues: *Property Tax Deduction:* The bill provides an AV property tax deduction for the increase in the assessed value of a residential property due to redevelopment or rehabilitation, provided the property is located in a residential redevelopment area. The deduction is a specified percentage of the AV increase as presented in the table below. The deduction may be claimed for 10 years.

Deductible Percentage of AV Increase	Duration of Deduction
100%	1^{st} through 3^{rd} years deduction is claimed.
50%	4^{th} through 6^{th} years deduction is claimed.
40%	7^{th} year deduction is claimed
30%	8^{th} year deduction is claimed
20%	9^{th} year deduction is claimed
10%	10^{th} year deduction is claimed

The bill defines *redevelopment* as the construction of a new residential structure on unimproved real estate or real estate where an old structure is demolished and replaced by a new residential structure. *Rehabilitation* is defined as the remodeling, repair, or betterment of residential property, or enlargement or extension of property, in which depreciable rehabilitation expenses are at least $25,000.

Additional deductions reduce the assessed value tax base. This causes a shift of the property tax burden from the taxpayers receiving the deductions to all taxpayers in the form of an increased tax rate. Total local revenues, except for cumulative funds, would remain unchanged. The revenue for cumulative funds would be reduced by the product of the fund rate multiplied by the deduction amount applicable to that fund. These impacts are indeterminable, but would be eliminated as deductions in the residential redevelopment areas phaseout and expire.

Potential Secondary Tax Impacts: To the extent that residential redevelopment areas encourage additional construction work in counties, these areas would affect revenue from local option income taxes (CAGIT, COIT, and/or CEDIT). The extent of this potential impact is indeterminable.

State Agencies Affected: Department of State Revenue, Department of Local Government Finance.

Local Agencies Affected: Indianapolis Metropolitan Development Commission, redevelopment commissions in second class cities, some counties and county auditors.

Information Sources: Mike Higbee, Development Concepts, Inc., (317) 262-9347. *Census 2000 Summary File 3 (SF 3) - Sample Data*, U.S. Census Bureau, http://factfinder.census.gov. *Building Permits Database,* U.S. Census Bureau, http://www.census.gov/const/www/permitsindex.html.

Fiscal Analyst: Jim Landers, 317-232-9869